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JOBS Act – SEC Guidance on Scaled Disclosure and Other Emerging Growth Company Issues

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On March 8, 2012, the U.S. House of Representatives approved a package of six bills designed to boost access to private capital—the JOBS Act. The U.S. Senate passed the JOBS Act on March 22, 2012 with some revisions. The House approved the Senate version on March 27, 2012. President Obama signed the JOBS Act on April 5, 2012.

The JOBS Act: provides that "emerging growth companies" will be exempt from certain financial disclosure and governance requirements for up to five years; eases restrictions on the sale of securities; and increases the number of shareholders a company must have before becoming subject to the U.S. Securities and Exchange Commission's (SEC's) reporting and disclosure rules. Download to read: memo discussing the JOBS Act. http://www.hinshawlaw.com/congress-passes-jobs-act-in-effort-to-make-raising-capital-easier-04-02-2012/.

Emerging Growth Companies. Many companies are reluctant to undertake an initial public offering (IPO) because in doing so they will become subject to various SEC rules and regulations thereafter.

The JOBS Act affords companies that file an IPO a temporary reprieve from certain SEC regulations by exempting an emerging growth company (EGC) from these regulations for up to five years. An EGC is defined as a company with total annual gross revenues of less than $1 billion in its most recently completed fiscal year. An EGC will retain such status until the earlier of: (1) the fifth anniversary of the date it first sold securities pursuant to an IPO registration statement; (2) the last day of the fiscal year in which it first exceeds $1 billion in annual gross revenues; (3) the time it becomes a large accelerated filer (an SEC registered company with a public float of at least $700 million); or (4) the date on which the EGC has, within the previous three years, issued $1 billion of nonconvertible debt.

Regulatory Relief for EGCs. The JOBS Act provides scaled disclosure provisions for EGCs, including, among other things:

- permitting EGCs to include only two years of audited financial statements in the registration statement filed under the Securities Act of 1933 (the 1933 Act) for an IPO of common equity securities;

- allowing EGCs to comply with the smaller reporting company version of Item 402 of Regulation S-K; and
- removing the requirement that EGCs comply with Sarbanes-Oxley Act Section 404(b) auditor attestation of internal control over financial reporting.

Recently, the SEC issued guidance on scaled disclosures and other EGC related issues.

Emerging Growth Company Revenue Test. An EGC is defined as a company with total annual gross revenues of less than $1 billion in its most recently completed fiscal year. The phrase "total annual gross revenues" means total revenues as presented on the income statement presentation under U.S. Generally Accepted Accounting Principles (GAAP). If the financial statements for the most recent year included in the company's registration statement are those of its predecessor, the predecessor's revenues would be used when determining whether the company meets the EGC definition.

EGC Effective Date. The JOBS Act provides that a company shall not qualify to be an EGC "if the first sale of common equity securities of such company pursuant to an effective registration statement" under the 1933 Act occurred on or before December 8, 2011.

The phrase "date of the first sale of common equity securities" under the JOBS Act could be:

- the date of a company's initial primary offering of common equity securities for cash;
- an offering of common equity pursuant to an employee benefit plan registered on a Form S-8; or
- a selling shareholder's secondary offering registered on a resale registration statement.

Even if its registration statement had been declared effective on or before December 8, 2011, a company may qualify as an EGC so long as the first sale of common equity securities occurs after December 8, 2011, assuming the company meets all of the other requirements of the EGC definition.

A company that qualifies as an EGC may amend its registration statement to provide the scaled disclosure available to EGCs even though the registration statement was initially filed prior to April 5, 2012.

The filing may be made in a pre-effective amendment to a pending registration statement or in a post-effective amendment.

Transitioning in and out of EGC Status. As part of the process, the EGC submits a confidential draft of its registration statement to the SEC for review. Once the review has been completed, the EGC publicly files its initial registration statement with the SEC with all prior confidential submissions included as exhibits to the registration statement. A company must qualify as an EGC at the time of submission of its confidential draft registration statement and throughout the entire review process. Download to read: memo discussing the procedures for making confidential submissions of draft registration statements. http://www.hinshawlaw.com/jumpstart-our-business-startups-act-jobs-act--confidential-submission-process-for-emerging-growth-companies-04-18-2012/.

If a company ceases to qualify as an EGC while undergoing the confidential review of its draft registration statement (for example, since the initial submission date, a fiscal year has been completed with revenues over $1

billion), it would need to publicly file a registration statement to continue the review process and comply with current rules and regulations applicable to companies that are not ECGs. At that time, the prior confidential draft submissions would be filed as exhibits to the registration statement.

Under SEC Rule 401(a), a company's status at the time of the initial filing date of its registration statement will determine the requirements for the contents of that registration statement. The filing of a confidential draft submission is not a "filing" for these purposes because it is not the filing of a registration statement. Under Rule 401(a), if a company completes the confidential review process and then files its registration statement at a time when it qualifies as an EGC, the disclosure provisions for EGCs would continue to apply through effectiveness of the registration statement even if the company loses its EGC status during registration.

Conversely, if a company submits a draft registration statement for confidential review at a time when it qualifies as an EGC, but files its initial registration statement at a time when it does not qualify as an EGC, then the initial registration statement would need to comply with the requirements applicable to registration statements filed by companies that are not EGCs.

Test-the-Waters Communications. New Section 5(d) under the 1933 Act allows "test-the-waters" communications, which may be made before the public filing of the registration statement with qualified institutional buyers (large institutional investors with more than $100 million in investments – QIBs) and institutional accredited investors. A company would need to determine whether it qualifies as an EGC at the time it engages in such communications. If an EGC made test-the-waters communications in reliance on Section 5(d) before the public filing of a registration statement, but it is no longer an EGC at the time it publicly files a registration statement, the earlier communications would not be deemed to violate this rule. Further test-the-waters communications in reliance on Section 5(d), however, would not be permitted if the company no longer qualifies as an EGC.

Disclosing EGC Status. When filing a draft registration statement, an EGC should disclose that it is an EGC on the cover page of its prospectus. This disclosure would be included in the confidential submission as well as the publicly filed registration statement.

An EGC should discuss its status in its prospectus and the risks associated with being an EGC. For example, an EGC should consider disclosing that it is exempt from the Sarbanes-Oxley auditor attestation rule and discuss the risks this may pose to the EGC.

Scaled Disclosure—Audited Financials and Selected Financial Data. As indicated above (*Regulatory Relief for EGCs*), an EGC is subject to scaled disclosure provisions. Under the JOBS Act, an EGC may elect to take advantage of some or all of these provisions and, if it chooses, to comply with the regular disclosure provisions (see, however, *Scaled Disclosures—Election to Comply With New or Revised Accounting Standards* below).

Section 7(a)(2)(A) of the 1933 Act provides that an EGC need not present more than two years of audited financial statements in a registration statement for an IPO of its common equity securities. This section also provides that, "in any other registration statement to be filed with the Commission, an [EGC] need not present selected financial data in accordance with section 229.301 of title 17… for any period prior to the earliest audited period presented

in connection with its initial public offering." Although Section 7(a)(2)(A) refers to "any other" registration statement, if an EGC presents two years of audited financial statements in its IPO registration statement, the number of years of selected financial data under Item 301 of Regulation S-K is limited to two years as well.

Technically, the JOBS Act provision permitting the filing of only two years of audited financial statements is limited to the registration statement for the EGC's IPO public offering registration statement. However, the SEC has determined that an EGC does not need to present audited financial statements in other registration statements for any period prior to the earliest audited period presented in connection with its IPO of common equity securities.

Scaled Disclosures—Election to Comply With New or Revised Accounting Standards. An EGC may chose not to take advantage of the extended transition period provided for complying with new or revised accounting standards. This provision allows EGCs to elect whether to comply, deferring compliance until it is no longer an EGC or deferring compliance until the standards are applicable to private companies.

An EGC "must make such choice at the time the company is first required to file a registration statement, periodic report, or other report with the Commission" and notify the SEC of its decision at the time of such filing. EGCs that currently are in registration or are subject to Exchange Act reporting should make and disclose their choice in their next amendment to the registration statement or in their next periodic report, respectively.

The decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

An EGC choosing to take advantage of the extended transition period for complying with new or revised accounting standards should look to SAB Topic 11M for disclosure guidance. For each recently issued accounting standard that will apply to its financial statements, an EGC that is taking advantage of the extended transition periods should disclose the date on which adoption is required for non-EGCs and the date on which the EGC will adopt the recently issued accounting standard, assuming it remains an EGC as of such date.

If an EGC decides not to take advantage of the extended transition period, it should:

- if using the confidential submission process, notify the SEC staff of its choice in the initial confidential submission;
- if currently in registration, disclose its choice in its next amendment to the registration statement; and
- if already subject to Exchange Act reporting, disclose its choice in its next periodic report.

Switching to Scaled Disclosure. An issuer that qualifies as an EGC and that has a registration statement that was initially filed before April 5, 2012 may switch to the scaled disclosure provisions available to EGCs in a pre-effective amendment to a pending registration statement or in a post-effective amendment. However, the SEC may seek other disclosures in response to the changed disclosure and EGCs should consider adding disclosure regarding the omitted information (for example, if the third year of audited financial statements removed represents poor financial results).

Conflicts with SEC Rules. Certain provisions of the JOBS Act conflict with SEC form requirements, Regulation S-X and Regulation S-K.

An EGC may comply with the JOBS Act disclosure provisions in its registration statements, periodic reports and proxy statements, even if doing so would be inconsistent with existing rules and regulations. The disclosure provisions in the JOBS Act supersede, in relevant part, existing rules and regulations.

For example, Section 102(c) of the JOBS Act, which was not enacted as part of the Exchange Act, provides that an EGC may comply with Item 402 of Regulation S-K by providing only the information required of a smaller reporting company, even if it does not qualify as a smaller reporting company. In addition, Section 103 of the JOBS Act, which also was not enacted as part of the Exchange Act, provides that an EGC is not required to comply with the requirements of Sarbanes-Oxley Section 404(b).

An EGC's CEO and CFO are required to certify in their Sarbanes-Oxley Act Section 906 certifications that the company's periodic report fully complies with the requirements of Sections 13(a) or 15(d) of the Exchange Act.

Financial Statements of Other Entities. In addition to presenting its own financial statements, an EGC may be required to present up to three years of financial statements of other entities in its registration statement, based on the significance of those entities (*e.g.,* financial statements of acquired businesses).

If the significance test results in a requirement to present three years of financial statements for these other entities, an EGC need only present two years of financial statements for these other entities in its registration statement.

Sale of Nonconvertible Debt. The JOBS Act provides that a company will lose its EGC status on the "date on which such company has during the previous three-year period, issued more than $1,000,000,000 in non-convertible debt," provided that none of the other EGC disqualifying conditions have been triggered.

The three-year period covers any rolling three-year period. It is not limited to completed calendar or fiscal year. As of any date on which a company has issued more than $1 billion in nonconvertible debt over the three years prior to such date, the company will lose its status as an EGC, provided that none of the other disqualifying conditions have been triggered.

"Nonconvertible debt" means any nonconvertible security that constitutes indebtedness, whether issued in a registered offering or not.

Foreign Private Issuers. If a foreign private issuer comes within the definition of an EGC, it may use the confidential submission procedure to the same extent as a domestic EGC. Qualifying foreign private issuers must submit the draft registration statement in the same manner and to the same address as domestic EGCs.

If the foreign private company chooses to take advantage of any benefit available to EGCs, then it will be treated as an EGC and required to publicly file its confidential submissions at least 21 days before the road show. If the

foreign private company chooses not to take advantage of any emerging growth company benefit, then it may follow the SEC's Policy on Non-Public Submissions from Foreign Private Companies.

The SEC will not object if a foreign private company that qualifies as an EGC complies with the scaled disclosure provisions available to EGCs to the extent relevant to the form requirements for foreign private companies.

An EGC is defined as a company with total annual gross revenues of less than $1 billion in its most recently completed fiscal year as reported under U.S. GAAP (or International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), if used as the basis of reporting by a foreign private company). If a foreign private company's financial statements are presented in a currency other than U.S. dollars, total annual gross revenues should be calculated in U.S. dollars using the exchange rate as of the last day of the most recently completed fiscal year.

Foreign Private Issuers—Canadian Companies. A Canadian company filing under the Multi-Jurisdictional Disclosure System (MJDS) may qualify as an EGC.

However, the disclosure requirements for a Canadian EGC would continue to be established under its home country standards in accordance with the MJDS, other provisions of Title I, such as the test-the-waters provision in Section 5(d) of the Securities Act and the deferral of compliance with Section 404(b) of the Sarbanes-Oxley Act, would be available to an MJDS filer that qualifies as an EGC.

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